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Pension  
Protection  
Fund

# **The 2012/13 Pension Protection Levy Policy Statement**

December 2011

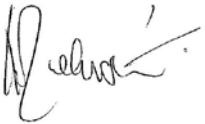
## Foreword

I am delighted to introduce our policy statement concluding the consultation on the levy rules for 2012/13. Alongside this document the Board is making its Determination of the Levy Rules for 2012/13.

This forms the culmination of our work to develop a New Levy Framework that will deliver greater predictability and stability for levy payers – through setting the rules for a three year period.

The current uncertain economic climate emphasises the importance of the Pension Protection Fund. It also reinforces the importance of our thinking long-term about our funding position and the role of the levy in delivering the certainty that members and other stakeholders need about our ability to continue to pay compensation.

I am grateful for the effort that has gone into Stakeholders' responses. Without doubt the New Levy Framework, introduced from 2012/13, is much the better for the input that we have had from our stakeholders throughout the development process.



Alan Rubenstein

**Chief Executive**

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# 1. Introduction and Executive Summary

## 1.1 Overview of the Proposed 2012/13 Pension Protection Levy

### Implementation of New Levy Framework

- 1.1.1 The Board published a consultation document on 21 September 2011 setting out the basis on which it intends to charge the Pension Protection Levy for the 2012/13 levy year. As part of this, the levy estimate, the risk-based levy scaling factor, the scheme-based levy multiplier and associated rules were published. A limited number of changes, particularly in relation to contingent assets, were proposed.
- 1.1.2 This document summarises responses and sets out the Board's final conclusions on policy issues discussed. It is not intended to be a full statement of how the New Levy Framework, implemented from 2012/13, will operate. It should be read in conjunction with the Policy Statement of May 2011, and the Consultation Document published in September 2011, for a full understanding of the New Levy Framework.

### The Levy Rules (the Determination) for 2012/13

- 1.1.3 The Levy Rules that will govern the calculation of levies for 2012/13, as specified in the Board's Determination under section 175(5) of the Pensions Act 2004, are published alongside this response statement.
- 1.1.4 Together with the Levy Rules we have published four documents providing guidance for schemes on how to meet the requirements of the Levy Rules, and to understand how we expect to make use of the areas where the Levy Rules provide us with flexibility. These are:
- Guidance on Contingent Assets;
  - Guidance on Investment Risk;
  - Guidance on Block Transfers; and,
  - The Levy Practice Guide

## 1.2 Summary of Responses

- 1.2.1 We received a total of 25 submissions to the consultation, which closed at 5pm on 2 November 2011. The Board would like to thank all respondents for their contributions. Key themes emerging from the consultation are discussed in the following pages.

## Strength of Type A Contingent Asset Guarantors

- 1.2.2 The largest response was on the proposals relating to contingent assets – and in particular those to toughen the requirements for type A contingent assets (group company guarantees). These proposals, a response to concerns raised with us by the Actuarial Profession earlier in the year, close a loophole that currently allows contingent assets to be certified even where there is little prospect of the guarantor paying more than a fraction of the guarantee. We proposed that the trustees would have to certify that the guarantor was able to meet the sum guaranteed, and additionally that we would carry out analysis using publicly available data.
- 1.2.3 Responses to the consultation proposals on contingent assets generally supported the principle behind them. However, it was suggested that the certification requirement as framed would be difficult and potentially costly to comply with, even for those with very robust contingent assets. Comments also highlighted the importance of further guidance, and suggested particular areas where such guidance would be necessary.
- 1.2.4 We have developed a revised certification – basing it on a proposal from one of the consultation responses – which we believe will make it easier to certify whilst still reducing the scope for guarantees of little or no value to be certified.
- 1.2.5 Recognising the importance of getting this balance right if we are to tackle the issue of schemes gaining disproportionate benefit, without undermining valuable arrangements, we have tested the revised certification and guidance with those making relevant comments in the consultation, and published the guidance on contingent assets in draft. We are grateful to those who took time to help us with this, particularly in view of the inevitably tight deadline for comments. The guidance has been substantially extended, to provide more information for trustees and their advisers, as a result of that input.
- 1.2.6 We have also taken steps to allow trustees to certify for levy purposes part rather than all of a guarantee, if their view is that this is a more appropriate recognition of the degree of support that might be expected.
- 1.2.7 In relation to the work that we will undertake in relation to the strength of guarantors, this policy statement indicates that we do intend to do our own analysis, but that for 2012/13 we will aim to give schemes the benefit of the doubt, where in our view the guarantee provides substantial benefit even if this is not quite at the level that is implied by the levy.

## Levy Estimate and Parameters

- 1.2.8 There were relatively few points made in relation to the levy estimate and the proposed parameters. In response to questions about the sustainability of our reduced levy estimate of £550 million, we note that the Update to the Funding Strategy published alongside our 2010/11 Report and Accounts, suggests that after reflecting the reduction in levy estimate our probability of achieving our funding target remains above 80%. The shift to a lower quantum was not a temporary reduction made in the expectation of recouping the reduction in later years.

## Investment Risk

- 1.2.9 Consultation responses included points in relation to the detail of the bespoke assessment of investment risk that the largest schemes must carry out – mostly suggesting increased detail or allowing different options in the treatment of assets. There was also a challenge to the suggestion that schemes that voluntarily provide a bespoke test in one year would be expected to do so in later years.
- 1.2.10 In relation to the bespoke investment risk test, the points in general run counter to points made by stakeholders in the previous consultation. These earlier comments emphasised keeping the bespoke test reasonably straightforward and being prescriptive so that different advisers would not come up with radically different answers in similar circumstances. We have not therefore made significant changes, but have clarified a number of points.
- 1.2.11 In relation to voluntary submission, we have indicated that we are content for schemes that find the benefits of reporting a bespoke test in 2012/13 do not justify doing so in future years to cease reporting. The exception to that would be if a scheme was using derivatives to de-risk, and at times to increase its risk above the level apparent from its reported asset breakdown. Such a scheme should use the bespoke approach consistently (or not at all).

## Insolvency risk

- 1.2.12 Consultation responses also included points in relation to the averaging of failure scores.
- 1.2.13 We propose to take on board the proposals in relation to monthly averaging. If D&B have data for a number of months in 2011/12, but not all months, they would produce an average based on those that they have.

## 1.3 Next Steps and Key Dates

1.3.1 To ensure that schemes receive a levy invoice appropriate to the real level of risk posed, it is important that scheme and employer information is reported accurately. In particular, the introduction of investment risk in the New Levy Framework means that the asset breakdown reported on Exchange may have a significant impact on bills.

1.3.2 Key dates for the 2012/13 levy year are set out below.

- Information from the scheme return submitted by 5pm on 30 March 2012 will be used in the calculation of levies. The Pensions Regulator's Exchange system will continue to be the sole point of data submission for the purposes of the PPF levy.
- Insolvency risk will be measured using the average Failure Score of each sponsoring employer measured on the last working day of each month, from 28 April 2011 to 30 March 2012<sup>1</sup>.
- The deadline for certification and/or re-certification of contingent assets will be 5pm on 30 March 2012.
- Deficit reduction contributions that have been made up to and including 31 March 2012 must be certified by 5pm on 10 April 2012.
- Full block transfers that have taken place up to and including 31 March 2012 must be certified by 5pm on 29 June 2012.
- We will use market data over five years to smooth funding levels when we transform section 179 valuations to a common date. For levy year 2012/13, we will use market data for each working day in the 5-year period up to 30 March 2012.

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<sup>1</sup> This is provided month-end scores are available. For some countries D&B will collect data monthly from partner companies, which may be at a date other than the month end. Countries affected are specified in the Determination. Some entities may only have sufficient data to have a single, annual score.

## **2. The Levy Estimate and Parameters for 2012/13**

### **2.1 Introduction**

- 2.1.1 The consultation document set out the proposed levy parameters for 2012/13. There were limited comments on the levy estimate and the levy parameters, and no changes have been made. We have provided more information on some points questioned in responses.

### **2.2 Summary of Responses**

- 2.2.1 There were limited comments on the levy estimate and the levy parameters. While these welcomed the level at which the estimate was set, two respondents encouraged us to improve the transparency of the assumptions and objectives underlying the £550 million figure. In particular, they were concerned that the reduced estimate for 2012/13, and those expected for the subsequent years of the triennium, might be a temporary reduction in recognition of the difficult economic conditions and poor growth prospects, with an expectation of higher levies later.
- 2.2.2 One respondent sought clarification on the extent to which the various factors and rates used in the levy calculation, other than the levy parameters, would be fixed.

### **2.3 The Board's Confirmed Policy**

- 2.3.1 The Board set the levy quantum having regard to a range of factors, including the most up to date information available to it on our funding position, and the implications for our funding strategy
- 2.3.2 As indicated in the Update on the Funding Strategy published in November 2011, alongside our Annual Report and Accounts, our latest assessments show that the probability of achieving self-sufficiency measured on our base case had improved from 83 per cent in March 2010 to 87 per cent in March 2011. In that context, whilst the future is necessarily uncertain, and there are particular questions over the immediate economic outlook, the decision to set a levy at £550 million was not taken in the expectation of an increase in later years.

2.3.3 The levy parameters that will apply for 2012/13 are as follows:

- The risk-based levy scaling factor (LSF) will be 0.89;
- The cap on the risk-based levy will apply at 0.75 per cent of smoothed liabilities; and,
- The scheme-based levy multiplier (SLM) will be 0.000085

2.3.4 Our policy to provide stability and predictability to schemes covers the broad framework by which levies are calculated. The intention to fix as many of the rules as possible extends to rates and factors beyond the LSF, SLM and cap, in particular to the Levy Rates and the asset stresses applicable to the range of asset categories. We will monitor the levy estimate we expect to raise in future years based on these rules to ensure that the estimate is in line with the conditions we have set ourselves, as detailed in earlier publications.

## **3. Underfunding and Investment Risk**

### **3.1 Introduction**

- 3.1.1 From 2012/13, the measurement of underfunding will incorporate assessment of investment risk. Most of the rules relating to investment risk had already been announced in previous consultations on the New Levy Framework policy in October 2010, and in the draft guidance for the bespoke calculation of investment risk in May 2011.
- 3.1.2 New policy set out in the draft 2012/13 Levy Rules was limited. The main new elements since the May Policy Statement were, as had been indicated, the final asset and risk factor stresses, which were updated to include further data. Although a new Investment Risk Appendix was released, it followed the bespoke guidance closely, and received just one comment.
- 3.1.3 Prior to the May consultation, a number of respondents to the October consultation had indicated serious concerns around the cost of the bespoke analysis. From responses received to this consultation it appears that concern has receded, perhaps reflecting engagement in developing the guidance.
- 3.1.4 In response to the May consultation, a number of clarifying amendments to the guidance and Exchange help file were made. In particular, we provided elaboration on the dates at which the calculation had to be made, and by when the results had to be reported. We also clarified that the bespoke results should be reported annually (at a minimum); there were no concerns raised in relation to this.

### **3.2 Summary of Responses**

- 3.2.1 We received comments on our approach to investment risk from a total of ten respondents. Areas on which issues were raised ranged from the methodology underlying the asset and risk factor stresses, to reporting deadlines for bespoke results.
- 3.2.2 A few submissions highlighted the potential for schemes to face two deadlines in reporting their bespoke results, once for their scheme return deadline and another for the PPF deadline of 30 March 2012. This could arise if audited financial information became available after the scheme return deadline, and the scheme considered that it would be preferable to use the more recent investment information for the purposes of the bespoke analysis. We indicated in the guidance that the option of

updating the bespoke information was available, as long as this was submitted by the PPF deadline of 30 March 2012.

- 3.2.3 One stakeholder asked for more information on the treatment of schemes that were subject to the investment risk stress threshold (i.e. had liabilities of above £1.5 billion) but did not report the results of a stress test.
- 3.2.4 A few respondents reiterated their views that the treatment of annuities does not provide for appropriate recognition of the risk reduction achieved. Other methods that could improve the accuracy of this were proposed, for example, the deduction of section 179 annuities from both assets and liabilities prior to the roll-forward.
- 3.2.5 A few stakeholders suggested changes to the rules for the bespoke approach to introduce additional flexibility – for example:
- That consultants should be able to ignore elements of the bespoke calculation if they would be expensive to perform in respect of an individual asset;
  - That we should allow the outputs from an internal model to capture full diversity of investment strategies;
  - That recognising only intrinsic value was a simplification e.g. for collar strategies;
  - One stakeholder suggested we allow asset information from sources other than audited accounts, such as an audited asset statement.
- 3.2.6 There were also requests for more information on the policy that schemes choosing to submit bespoke results should be expected to continue to do so in future years. As there would be long-term implications for schemes making that decision for the 2012/13 levy, respondents asked that more detail on how schemes would be treated if they chose to stop their voluntary reporting. There were also suggestions for circumstances in which schemes could be allowed to opt out without any penalty, for example, if the costs became disproportionately high relative to the levy reduction.

### 3.3 The Board's Confirmed Policy

- 3.3.1 The Board considered the concerns around the potential for scheme return deadlines and PPF deadlines to create an additional cost for schemes. No changes have been made to the reporting deadlines for bespoke results.
- 3.3.2 The relevant fields will be voluntary for schemes that have liabilities below the £1.5 billion threshold; these schemes will have until 5pm, 30 March 2012 to enter and submit their bespoke results. They may therefore plan the date of submission so that it is consistent with their accounting schedule.
- 3.3.3 For schemes meeting the section 179 liabilities threshold, the completion of these fields will be mandatory.
- 3.3.4 In terms of deadlines for reporting, our proposals provided flexibility as to which set of audited accounts could be used, so that if a new set became available during November-March, it would be open to the scheme to submit bespoke results using the updated accounts. Schemes would only do so if they wished to report more up to date results. In any case, the results of such an update would be likely to be needed for the following year's scheme return, so this would be work done early rather than additional work.
- 3.3.5 We note that a few responses took the opportunity to reiterate points made in previous consultations on the lack of flexibility entailed by the bespoke approach. One respondent argued that the bespoke approach was not sufficiently bespoke to take into account the complexity and diversity of investment strategies, so internal models should be allowed. In the previous consultation on the New Levy Framework there was a clear message from stakeholders that we should avoid too much optionality in the bespoke approach as otherwise different advisers would come up with non-comparable results. We considered this closely in developing the bespoke approach (a number of stakeholders suggested we explore it), and decided against as it could introduce complexity and subjectivity. We feel that being prescriptive in this respect is appropriate.
- 3.3.6 In relation to the use of audited assets statements, raised by one stakeholder, we have concerns about our ability to define what would be useable, and what would not, sufficiently clearly to ensure that the bases those reporting used would be truly comparable. Our approach looks for reporting of long-term changes in risk, for example excluding short-term derivatives positions; in addition, annual statutory accounts mean that any delay in recognising a new strategy would be limited. Accordingly, we have not sought to change this rule in 2012/13, although we would

- consider a relaxation of the rule in this area for 2013/14, if stakeholders can propose a satisfactory definition.
- 3.3.7 We consider that the basis on which the New Levy Framework is being implemented does give reasonable reflection of annuities risk, and we have twice altered the proposals in order to give annuities more weight. Whilst we understand that it might seem a neater approach to net off annuities, practical considerations have led us to reject this approach. In particular, this would require a very substantial re-building of our IT system, which we think would be disproportionate to any increase in accuracy delivered.
- 3.3.8 A few responses questioned whether a scheme has chosen to provide a bespoke investment risk stress should be expected to continue to do so. The Board can see that, particularly with the bespoke approach being new, it is quite conceivable that a scheme might find that carrying out the test had less impact on the levy than expected, and if such a scheme maintained a similar investment strategy in later years it might therefore not wish to repeat the bespoke test. The Board has no wish to “trap” schemes in this situation into continuing to perform bespoke tests.
- 3.3.9 On the other hand, we consider there is at least the potential for the bespoke test to be gamed, if schemes were from time to time shifting derivative strategies between risk-reducing and risk-enhancing - so that in some years a bespoke test would lead to a higher levy than the standard test. To tackle this, we may seek to understand any unusual pattern in certification of bespoke tests, before recognising the results of a bespoke test in a later year.

## 4. Insolvency Risk

### 4.1 Introduction

4.1.1 With relatively little change from the policy statement in May, comments on insolvency risk were limited in number, and focused on two issues. These were:

- The averaging of failure scores
- The treatment of scheme structure factors

### 4.2 Summary of Responses

#### Averaging monthly failure scores & availability of information

4.2.1 A few stakeholders noted that the draft Levy Rules say that where D&B do not have failure scores at the end of each month, the levy year end score is used. This would mean that if, for example, there are any gaps in monthly data, an average would not be constructed from the available scores. Responses suggested we either take an average based on those months available, or use the 30 March figure to replace any missing values (and then produce an average).

4.2.2 We were asked by a few stakeholders whether it would be possible to provide more information prior to the start of 2012/13. In particular two stakeholders asked for early publication of industry average scores.

#### Scheme Structure Factors and Guarantees

4.2.3 A number of stakeholders made points in relation to the treatment of scheme structure in the levy, and in particular the interaction between scheme structure factors and the account taken of contingent assets. At present, in considering whether to substitute a guarantor insolvency probability for a scheme insolvency probability, scheme structure factors are disregarded for the guarantor insolvency probability only. The draft Levy Rules aimed to maintain the current approach with the move to substituting guarantors at employer level – so that in each case the employer levy rate will be reduced by the scheme structure factor, but the guarantor levy rate will not, and then whichever levy rate is better will be used in the calculation.

- 4.2.4 A number of stakeholders flagged an inconsistency in the drafting of the Levy Rules, which would mean that the intended effect was not delivered.
- 4.2.5 One stakeholder argued that the intended approach was, in any case, wrong and that the scheme structure factor should continue to be applied at scheme level.

### **4.3 The Board's Confirmed Policy**

#### **Averaging monthly failure scores & availability of information**

- 4.3.1 The current rule was drafted on the expectation that whether or not monthly scores were available was largely driven by whether D&B would have to access information from partner companies routinely. It was expected that in general D&B will either have 12 months data or only year-end data, and the Levy Rules rule was kept simple for that reason.
- 4.3.2 However, experience with the first few months of data in 2011/12 has highlighted some gaps in data for individual months. In those circumstances, the policy intention of using an average of the monthly scores would apply to a smaller than anticipated number of schemes. Therefore, the Levy Rules have been redrafted to allow for the production of an average from whatever monthly data is available even if the full 12 months' data is unavailable. D&B will be working to ensure that in as many cases as possible monthly data will be available consistently. We have also agreed with D&B that they will seek to have data available monthly from all countries (currently this would cover about 80 per cent of overseas employers/guarantors). Where this is obtained from certain partner organisations this may in some cases be a score that is from a date a few days removed from the month end. We consider it is better to use these for the remaining 20 per cent of overseas employers/guarantors than to only use year-end scores for affected countries).
- 4.3.3 In respect of early publication of industry averages, we do not propose to alter current arrangements, which see the averages published after 31 March. There are two reasons for this – one practical and one of principle. Practically speaking, it would be difficult to calculate an industry average before March 2012 because D&B would not know the make-up of the groups being averaged or what scores the employers making up the average have achieved. And in principle we would wish to see all schemes provide sufficient information on the employers to the scheme for all employers to be uniquely identified by D&B and receive an appropriate failure score. Schemes should not view an industry average as something that they have a "right to" nor should they be assessing whether providing more or less information might be to their advantage. The appropriate way for trustees to achieve certainty about future bills is

to work with D&B to ensure that employers can be identified and given a failure score.

### Scheme Structure Factors and Guarantees

- 4.3.4 The switch to substituting contingent assets employer by employer was included to reflect the situation where a group company that was not the strongest in the group was the one that offered the guarantee. In such a situation, because the guarantor is often already an employer to the scheme, the benefit of dispersion of risk from having a last man standing structure doesn't apply to that guarantor – only to the employer whose risk of failure we would “ignore” through the substitution.
- 4.3.5 We have therefore concluded that an approach that continues the current approach of applying scheme structure factors only in relation to insolvency risks derived from employers (and not from guarantors) remains appropriate.

## 5. Risk Reduction: Contingent Assets

### 5.1 Introduction

5.1.1 The Consultation document indicated that only limited changes to the contingent asset regime would be made in 2012/13, with a more substantial review of the regime to follow during the first triennium of the new levy framework.

5.1.2 We set out three changes proposed in relation to the treatment of contingent assets, regarding:

- The requirement for chargors, guarantors, and purchasers to be an associate, in strict legal terms, of an employer;
- The recognition of Type A contingent assets in multi-employer schemes;
- Consideration of the ability of guarantors of Type A contingent assets to meet the guarantee.

5.1.3 The first two of these proved uncontroversial, and will be implemented as proposed. For the third, though, relating to guarantor strength, we have made modifications in relation to the proposals.

### 5.2 Overview of Proposals

5.2.1 We proposed to amend the definition of “associate” so that an entity which satisfies the Board of a sufficiently strong connection to an employer, independent of the existence of the contingent asset, would be recognised as an associate. The proposal still required a genuine connection between the guarantor or chargor or purchaser and the employer – to be certified on Exchange – and for evidence of the connection to form part of an affected scheme’s paper contingent asset submission.

5.2.2 We also proposed that, where a Type A contingent asset is provided for a multi-employer scheme, the Levy Rate of the guarantor will only be substituted for those employers which have a higher Levy Rate. If any employers have a lower Levy Rate (i.e. pose less insolvency risk) than the guarantor, they will be able to carry this through to the calculation of the scheme’s Insolvency Rate.

- 5.2.3 The consultation document, in response to concerns raised with us by stakeholders earlier in the year and subsequent internal analysis, set out proposals to close a loophole that currently allows guarantors to be recognised through the levy even where there is little prospect of the guarantor paying more than a fraction of the guarantee<sup>2</sup>.
- 5.2.4 We proposed requiring schemes to certify on Exchange that each guarantor of a new or existing Type A contingent asset could be expected to meet their full commitment under the contingent asset if called upon to do so as at the date of the certificate. Alongside this, we indicated that we would also assess guarantor strength ourselves using publicly available information and then challenge those where the reduction in levy that would result from recognition of the contingent asset was not consistent when compared with the reduction in risk.

### 5.3 Summary of Responses

- 5.3.1 A number of responses welcomed the relaxation of the requirement for a guarantor to be an associate, and there was also positive comment on the shift to assessing whether to perform a risk switch employer by employer. A few stakeholders flagged a possible contradiction between the draft Levy Rules and the Contingent Asset Appendix in describing the interaction of this change and the scheme structure factors.
- 5.3.2 The most commented on aspect of the proposals was the addition of an assessment of the ability of a guarantor to meet the guarantee. Responses to the consultation proposals on contingent asset guarantor strength generally supported the principle behind the proposal. On the other hand, a couple of responses argued that there is no test of the ability of the sponsoring employer to meet the underfunding of the scheme, and argued that it was inconsistent to consider this in relation to a guarantor.
- 5.3.3 For most, the principal concern was that the certification requirement as framed would be difficult and potentially costly to comply with, even for

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<sup>2</sup> An example of this loophole is provided by two pension schemes from a major UK group. In 2011/12 the pension schemes added an additional guarantor, alongside the existing guarantor which is the main holding company, a substantial company but with a moderate failure score. The additional guarantor is a business with minimal net assets, which from its name appears to provide administrative services to the group, but which has a failure score close to 100. As a result their 2011/12 levies reduced by nearly 90 per cent, saving the schemes nearly £1million, but it is hard to believe that the PPF's risk has reduced.

- those with very robust contingent assets. The main reason cited was the requirement to confirm positively that the guarantor was good for the full potential value of the guarantee. There was a widespread view that the PPF was effectively asking for an annual covenant review of all guarantors, and that this would be a disproportionate expense. It was also questioned whether even a standard covenant review would be sufficient as this might not consider factors that would be important to the level of recovery. Some respondents also said that assessing by reference to net assets had limitations, as, for example, the assessment would not take into account the liquidity of those assets.
- 5.3.4 Comments also highlighted the importance of further guidance to clarify expectations of trustees in certifying, and suggested particular areas where such guidance would be necessary.
- 5.3.5 A few responses suggested that the guarantor or a representative should provide assurance about its ability to meet the contingent asset and not the scheme that is certifying the contingent asset. One suggested such a statement could be included with the required statement that corporate benefit has been considered.
- 5.3.6 It was suggested by some respondents that where there is more than one guarantor party to a contingent asset, it would be more appropriate to consider whether collectively the guarantors can meet the commitment that they are making – rather than that each individually should be able to. It was argued that, in practice, the guarantee is delivered if acting together the guarantors have been able to top up the scheme to the level committed to.
- 5.3.7 Other comments on the certification requirement included suggesting a delay to 2013/14, or implementation only in relation to new contingent assets. There were also a small number of responses that proposed specific alternate approaches including a suggestion that the PPF opt for a negative certification – that there is no reason to believe that the guarantor could not meet their full commitment under the contingent asset.
- 5.3.8 Finally, a few responses expressed concern about the application of a PPF test in addition to the certification – for example, some questioned the implications of a rejection by the PPF of a contingent asset that trustees have certified, and were concerned that this could suggest that the PPF were taking the view that the certification had been wrongly given. There was also a desire for greater clarity about the circumstances in which we would be minded to reject a contingent asset on the basis of insufficient guarantor strength.

## 5.4 The Board's Confirmed Policy

- 5.4.1 The proposals for a revised associate rule and consideration of guarantor substitution at employer level will be taken forward as proposed in the consultation, with drafting of the Levy Rules clarified. The proposals in respect of guarantor strength will be taken forward in a modified form.

### The case for certification of Guarantor strength

- 5.4.2 A few stakeholders argued that it is inconsistent to consider a guarantor's ability to meet the full deficit on the pension scheme as there is no test of the ability of the sponsoring employer to meet the underfunding of the scheme.
- 5.4.3 The legislation governing the Pension Protection Fund Levy requires us to assess the risk of employers becoming insolvent, rather than ability of those employers to pay. By contrast, the recognition of guarantor contributions to reducing the PPF's risk is an entirely voluntary extension to the risk-based levy regime, and it is essential therefore that any risk reduction recognised is genuine if the compulsory cost of the levy to schemes (including those either not certifying contingent assets or certifying those of real value) is not to be inappropriately increased. It is reassuring that most responses were supportive on the principle, and we intend to proceed with steps to assess guarantor strength.
- 5.4.4 However, given the concerns about our initial proposals, we have reconsidered the proposed approach. Whilst it might have been possible to allay concerns about our expectations of those certifying contingent assets – it has, for example, never been our intention that there should be a widespread commissioning of covenant reviews – we saw a risk that trustees and their advisers would feel they had to “play it safe” if a positive certification was required. This could mean that some contingent assets of real value would not be certified, or indeed put in place at all. This would run counter to our desire to promote appropriate risk reduction. We might also, as stakeholders note, be placing a cost even on to those schemes with the most robust of arrangements, if they wish to certify.

### Our revised approach

- 5.4.5 We have therefore modified the certification that will be required regarding guarantor strength. We are also taking this opportunity to clarify our intentions in this policy statement, as well as through the guidance that we have developed in partnership with stakeholders (which

- we published on our website in draft form last month, and are confirming today).
- 5.4.6 We have adopted a “negative certification” along the lines proposed to us, so that trustees (or their authorised representatives) will be required to certify that: “The trustees have no reason to believe that each certified guarantor, as at the date of the certificate, could not meet its full commitment under the contingent asset as certified.” We believe this should be a certification trustees are in a position to form an opinion on.
  - 5.4.7 With a shift to negative certification, we think any question as to whether trustees are the best party to certify is overcome. As the Guidance suggests, there may be cases in which the trustees choose to ask for a confirmation from directors of the guarantor. But that will depend on the particular circumstances of scheme and guarantor, rather than being something the PPF requires generally.
  - 5.4.8 We have also altered the certificate so that trustees have the option of certifying a lower amount than the face value of the contingent asset, or of only reporting the most substantial guarantors, if they do not feel that they can otherwise provide the certification regarding the guarantor’s strength. So, for example, if the trustees have been given a guarantee for 105 per cent of the section 179 liabilities of the scheme, but consider the guarantor’s ability to meet the guarantee is limited to £50 million, it would be open to them to place such a cap on the sum certified for levy purposes (in addition to the section 179 cap).
  - 5.4.9 We have made this change for two main reasons. First, to recognise that trustees may still have a legitimate interest in securing a guarantee for an amount higher than they know the guarantor may be able to provide now (for example, if it ensures that the guarantor, if a group company, is more likely to support the employers to avoid the guarantee being called upon). Secondly, we recognise that certification of contingent assets could be difficult if the agreement itself had to be formally amended every year to take into account the extent that the guarantor could offer support.
  - 5.4.10 We consider that the negative certification, coupled with the flexibility to reduce the sum certified on Exchange, will enable our policy to achieve its goal in better aligning risk and levy reductions, without unduly constraining the ability of trustees to enter into or certify contingent assets.
  - 5.4.11 Simplifying the certification of guarantor strength does, however, increase the importance of carrying out our own assessment.

## The PPF's assessment of guarantor strength

- 5.4.12 Our analysis for 2012/13 will be based on a straightforward comparison of publicly available financial information (principally the net asset value of the entity<sup>3</sup>) with the value that would be attributed to the contingent asset in the levy, if it were recognised. Except in some cases where the maximum liability under a contingent asset is limited in nominal terms (to a maximum sterling figure), this will be assessed reflecting the funding position of the scheme on the basis set out in the transformation appendix to the Levy Rules (i.e. on a smoothed and stressed basis), to estimate the "gap" the guarantor's promise is covering. Where the value of the business appears insufficient, the scheme will be provided with an opportunity to make representations as to why the guarantor would in fact be able to meet the guarantee, but in the absence of evidence the guarantee will not be recognised.
- 5.4.13 As a number of consultation responses noted, having a net assets position in recent accounts that is equal to the guarantee would not necessarily mean that the guarantee would be met in full. Responses cited the existence of other charges, difficulties in repatriating funds, and the possibility that failures of group companies would weaken the guarantor or mean that shareholdings in group companies were written down, amongst a range of reasons. Accordingly, it would be reasonable for the PPF to build in a margin and ask schemes for further evidence at a somewhat higher threshold than a guarantor's net assets being at the same level as the guarantee's maximum value.
- 5.4.14 However, given that this is the first year in which a formal test of guarantor strength will apply and that the basis on way in which bills are calculated is also new (as a result of introducing the New Levy Framework), it is our intention to apply our consideration in a way which gives the benefit of any doubt to schemes and their guarantors. Accordingly, we will not apply any discount to the net assets of guarantors in comparing them with the guarantee, and expect only to challenge guarantees where the net assets are somewhat below the sum guaranteed rather than applying an exact comparison. Trustees should not, however, rely upon any particular lower threshold of guarantor strength as satisfying our requirements.

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<sup>3</sup> Where net assets are limited a business may still have real value if it is cash generative, so profitability or like information may also be considered, as the business could either generate the sum required for the guarantee or be sold.

- 5.4.15 We will review the impact of the measures to take account of guarantor strength after their first year of application. However, it is our expectation that for future years the requirements are likely to be tightened. This would recognise increased familiarity with the rules and also that it will be easier for schemes to understand the valuation of contingent assets in levy terms without necessarily requiring expensive advice. (Given the stability introduced by the New Levy Framework it will generally be the case that a scheme's measured underfunding will be easier to predict based on the previous year's bill than has been the case to date.)
- 5.4.16 If we consider the guarantor to be of limited strength, we will seek additional evidence from the trustees, before deciding whether to reject a contingent asset.
- 5.4.17 Generally, guarantees with guarantors unable to meet the full value of the guarantee certified will be wholly rejected even where the contingent asset may be considered to have some value. Widespread use of partial recognition could encourage the use of under-resourced guarantors (e.g. listing a series of guarantors, of varying substance and levy rate to see what could be got away with) which would make it hard to sustain our preferred approach of giving schemes the benefit of the doubt.
- 5.4.18 However, we recognise that there has been a change in the requirements for guarantees this year, and we will, therefore, consider partial recognition (particularly for recertified contingent assets), if the circumstances justify it and there has clearly been no intention to seek to gain an unfair levy advantage. However, schemes should not assume that the Board will exercise its discretion to partially recognise a contingent asset simply because the contingent asset is unchanged from 2011/12. The Board will only use the power to recognise in part in exceptional circumstances for new contingent assets.
- 5.4.19 More detail on this, including examples of where we might decide to partially recognise a certification and where we would not, are included in the Guidance.

### Contingent Asset Guidance

- 5.4.20 Given the importance of publishing the Levy Rules as soon as practicable after consulting, time has been limited to develop guidance that reflects consultation comments. However, recognising the value of gaining stakeholder input, we have sought to engage further.
- 5.4.21 Firstly we tested the revised certification wording and initial draft guidance with a group of stakeholders that made relevant comments in consultation, and secondly, we shared a revised draft version of the

guidance on our website. The result, we believe, is guidance that is a substantially better source of answers to trustees' questions. We genuinely appreciate the effort that went into the guidance from stakeholders, who have played a valuable role in a collective effort to prevent the abuse of the levy rules and the undermining of valuable risk reduction as well as disproportionate cost for schemes.

- 5.4.22 The Guidance makes the following points on trustees' assessment of guarantor strength:
- The certification (in particular given that this is the first year of the new requirements) is deliberately aimed at ensuring that trustees can certify unless there are clear grounds not to.
  - Trustees should take proportionate and reasonable steps to reassure themselves as to whether the guarantor has sufficient value as a business for the level being certified.
  - Where it is sufficiently clear cut (in either direction) trustees may choose not to take specific active steps to review the relative values of the contingent asset and the guarantor.
- 5.4.23 The Guidance sets out some factors for trustees to take into account. The focus is deliberately on information that already exists – such as Section 179 valuation information and statutory accounts. It is not the Board's intention generally to require schemes to undertake considerable additional activity in order to certify a contingent asset – though it recognises there may be some "difficult cases" that require more work than others.

### Multiple Guarantors

- 5.4.24 In relation to consideration of multiple guarantors, we are not attracted to the suggestion that there should be a move away from the fundamental principle that liability is joint and several – which in essence is what is implied by the suggestion that guarantors should be assessed in aggregate.
- 5.4.25 To make such a change without altering the way the levy is calculated, would simply fail to tackle the behaviour set out at 5.2.3. To make the change, in a way that was carried through to the way the levy is calculated, would be highly complex (currently the insolvency risk of the strongest sponsor substitutes in its entirety, to be consistent an "aggregate regime" would need to blend the risks of all guarantors weighting for their relative ability to pay).

## **6. Next Steps for Schemes and Key Dates**

### **6.1 Introduction**

6.1.1 This chapter outlines next steps and key dates for the calculation of 2012/13 levies.

### **6.2 Reminder: Accuracy of Scheme and Employer Information**

6.2.1 To ensure that schemes receive a levy invoice appropriate to the real level of risk posed, it is important that scheme and employer information is reported accurately.

6.2.2 The Regulator's Exchange system became available for scheme returns on 5 December 2011. We would encourage schemes to check employer information, some of which is pre-populated, to ensure that it is accurate.

6.2.3 The introduction of investment risk in the New Levy Framework means that the asset breakdown reported on exchange may have a significant impact on bills. We recommend that schemes that are considering reporting substantial allocations to the the "insurance" or "other" categories, should consider seeking to record the underlying assets held if they are, for example, held in a pooled fund. The split of bonds and equities in a pooled fund could have a significant impact on the levy. As is indicated on Exchange, where necessary, information that is provided by a fund a manager at a date close to the scheme's accounts date is acceptable.

### **6.3 Key dates**

6.3.1 For 2012/13 levies, we will use information from the annual scheme return that is submitted via the Pension Regulator's Exchange system to calculate levies. The deadline for submission is 5pm on 30 March 2012, except as detailed on the following page.

Item	Key dates
Monthly D&B Failure Scores	Between 28 April 2011 – 30 March 2012
Submit scheme returns on Exchange	By 5pm, 30 March 2012
Reference period over which funding is smoothed	5-year period to 30 March 2012
Certification of contingent assets	By 5pm, 30 March 2012
Certification of deficit-reduction contributions	By 5pm, 10 April 2012
Certification of full block transfers	By 5pm, 29 June 2012
Invoicing starts	Autumn 2012

## 6.4 Comments on the Arrangements

6.4.1 The Board welcomes feedback on the consultation arrangements. If you have any comments, please contact:

Paul Reynolds  
 Director of Corporate Affairs  
 Pension Protection Fund  
 Knollys House  
 17 Addiscombe Road  
 Croydon  
 CR0 6SR

Telephone: 020 8633 4968  
 Email: [Paul.reynolds@ppf.gsi.gov.uk](mailto:Paul.reynolds@ppf.gsi.gov.uk)

6.4.2 If you have a general enquiry about the levy, please email us at: [information@ppf.gsi.gov.uk](mailto:information@ppf.gsi.gov.uk)

